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TAGS: [EFIN](#) [PREL](#) [PGOV](#) [GM](#)
SUBJECT: GERMAN TAX DRAGNET EXPANDS AMID GROWING
PUBLIC DISCONTENT

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11. (SBU) SUMMARY: The highly publicized raids by German law enforcement officials on Germany's rich and powerful in the ongoing tax evasion investigation threatens to ensnare hundreds of prominent citizens. It has also ignited a heated public debate on Germany's moral fabric and its ability to maintain its "social market economy" in a globalized world. The debate ranges from:

-- the role of the German intelligence service (BND), which lacks jurisdiction in tax matters and yet used public funds to pay for what was essentially stolen information in the case;

-- the adequacy of existing tax enforcement measures;

-- calls for a possible cap on top management salaries amid the fear that growing inequality in Germany undermines social cohesion -- an issue that SPD Finance Minister Steinbrueck (who has led the tax evasion campaign) is clearly hoping to exploit in the lead-up to the 2/24 elections in Hamburg; and

-- the role of Liechtenstein and other tax havens in Europe, which a range of commentators claim aid tax evasion on an "epic scale".

Cynics scoff that aside from a few scapegoats, the majority of the tax cheats will get off with a fine and a slap on the wrist, just as they have always have. But this time could be different. The scope of the raids and the intensity of public outrage over the longstanding practice of tax dodging by the rich could make this one of the signature political issues in the run-up to the 2009 national elections. END SUMMARY.

Deutsche Post CEO First to Fall

12. (SBU) Police and German tax authorities raided homes and offices in Frankfurt, Munich, Berlin, Hamburg, and North Rhein Westphalia beginning late last week. About 1,000 people are reportedly targeted in the investigation, and more than 100 new raids are underway. Investigators also searched the Munich branch office of Dresdner Bank, a subsidiary of Europe's biggest insurer, Allianz Insurance, as well as private banks "Bankhaus Metzler," Hauck & Aufhaeuser and UBS. Prosecutors announced plans to intensify their probe next week.

¶3. (SBU) The operation began in the morning hours on February 14 with a raid - with heavy media presence - on the private residence and offices of one of Germany's most prominent and respected executives, Deutsche Post CEO Klaus Zumwinkel. Accused of evading tax payments of more than one million euros via tax shelters in Liechtenstein, Zumwinkel avoided being held without bail by admitting to the charges brought against him and reportedly posting a bond of 1 million euros; he is facing a potential fine of up to 4 million euros. On February 15, Zumwinkel resigned after 18 years as head of Deutsche Post. Another prominent victim, Bavarian Data Protection Commissioner Karl Michael Betzl, suspended his duties after prosecutors searched his home and office on February 20. Betzl is suspected of having diverted several hundred thousand euros to Liechtenstein.

The Role of the BND

¶4. (SBU) The German government confirmed reports that the BND gave an informant approximately 4.2 million euros (\$6.14 million) for a compact disk containing Liechtenstein bank data on more than 1,000 tax-evasion suspects. Finance Minister Steinbrueck rejected criticism that the BND used taxpayer monies to pay for stolen information. "There would have been a cry of outrage had we let this opportunity go by," Steinbrueck said, stressing the government's intention to pursue and punish the perpetrators. Chancellery Chief Thomas de Maiziere, who also serves as the Federal Intelligence Commissioner, came to the defense of the BND: "Intelligence services are interested in reliable information - this information is.... more

BERLIN 00000224 002 OF 003

important than the reliability/scruples of the informant." However, Deutsche Bank chief economist Norbert Walter questions the ethics of the use of "stolen data." He predicts this will lead to a witch hunt of business executives.

¶5. (SBU) The standing Bundestag committee that oversees the intelligence services discussed the BND involvement in a special (closed) session on February 20. At issue is BND's mandate, which does not extend to tax evasion. BND officials indicated that they only acted as a facilitator between the informant and the Finance Ministry. However, several members of the Bundestag Oversight Committee have expressed concern over the BND's role. Max Stadler (FDP), the deputy chairman of the committee, noted: "The investigation of criminal acts is the job of the police, the tax investigators and justice officials, not the intelligence service - this strict separation must be kept."

Politicians Concerned Over Fallout

¶6. (SBU) Leading politicians -- among them SPD Finance Minister Peer Steinbrueck and CDU Economics Minister Glos -- have warned that the scale of tax fraud among the highest earners in Germany risks eroding Germany's social model. The case of Klaus Zumwinkel in particular triggered a debate over a possible cap on management salaries. Leading Social Democrats and Greens raised the issue of social fairness, highlighting the disproportionate rise in CEO salaries compared to regular employees and the fatcats' alleged ability to evade taxes. The head of the Association of German Industry, Juergen Thumann, said his organization would "shun" those who were not playing by the rules. Ludwig-Georg Braun, head of the German Chamber of Commerce and Industry, called on employers to behave as role models for society. Service sector

trade union Chief Frank Bsirske called for a tax rate of 80 percent for incomes over two million euros. (The current highest tax bracket is approximately 45% on those earning more than 250,000 per year.)

¶7. (SBU) Both the SPD and CDU called for tougher laws and punishment for tax evasion. A close advisor to Chancellor Merkel told EMIN that Merkel will hang tough and not let the tax cheats off with light sentences. FDP Chairman Guido Westerwelle, however, cautioned against knee-jerk reactions and said the current debate overlooked the fact that the overwhelming majority of business leaders were law-abiding citizens who pay their taxes. The debate will continue as parties gear up for the February 24 Hamburg state elections, in which issues of social fairness are expected to play an important role.

The Liechtenstein Angle

¶8. (SBU) In her February 20 meeting with Liechtenstein's Prime Minister Otmar Hasler, Chancellor Merkel demanded greater transparency of Liechtenstein's financial system and cooperation with German prosecutors. She pointed to a U.S.-Liechtenstein agreement providing for the taxation of foundations that could serve as a model for similar agreements with EU countries. Merkel pressed for quick progress toward an anti-fraud agreement between the EU and Liechtenstein and urged it to cooperate with the OECD on curbing unfair tax competition. Meanwhile, German media reported that as many as 50 German banks were actively involved in the set-up and administration of tax-evasion foundations in Liechtenstein. The German Government is backed by the EU and the OECD, with both voicing criticism over the existence of tax havens and the lack of financial transparency.

¶9. A leading Economic Institute in Munich told ConGen Munich that Liechtenstein was aiding tax evasion on an epic scale. This would continue until the EU not only gets tougher on Liechtenstein, but also on other well known tax havens such as Switzerland, Monaco, and Andorra. The Institute lauded the U.S. agreement with Liechtenstein on withholding taxes on interest payments and commented that the U.S. had greater bargaining power than continental Europe because it

BERLIN 00000224 003 OF 003

could credibly threaten to bar Liechtenstein banks from U.S. financial centers. The EU has no such leverage because it was internally divided -- with the UK and Ireland in particular resisting such a crackdown. Likewise former German Finance Minister Eichel told us that "Liechtenstein is actually only a small fish in the pond, the bigger culprit is Switzerland." He expressed hope that the U.S. would help reform the current system.

The Political Angle

¶10. (SBU) The tax evasion scandal has become the talk of the town. At several recent events, senior business executives expressed concern to Ambassador Timken that the scandal would play directly into the hands of Die Linke. Already since its success in state elections in Essen and Lower Saxony on January 27, support for the Die Linke Party, the former Communists, has risen. Former FDP Chair Gerhardt noted to the DCM that the Liechtenstein scandal may hit many people, including members of the FDP. It could also affect the results of the Hamburg elections.

¶11. (SBU) Others, however, worry that those caught

red-handed will avoid punishment. Germany's ILO Representative told Econ Counselor that he fears that "nothing will change" and that the guilty will do little if any jail time. Referring to recent losses of German banks in risky sub prime transactions, as well as other scandals, he noted that there is a culture of unaccountability for the elite.

Comment

¶12. (SBU) The current wave of investigations has clearly struck a chord with a German public that has seen wages stagnate and purchasing power of "ordinary citizens" erode over the last few years while top executives' pay rose sharply (e.g., an average of 17.5% in 2007). Our contact at the Chancellery put it this way: there is a common perception that globalization has hurt the little guy, but immensely helped the rich -- who then routinely cheat on their taxes. The CDU can't be seen as the ally of the malefactors. Nor can Chancellor Merkel remain silent. But there is more: Merkel and her counterparts in the SPD -- both representing establishment parties with much to lose in the current scandal -- seem to share public outrage over the behavior of the many presumably wealthy individuals under investigation. Germany, more than the U.S., frowns upon social inequality. Already the debate over "social injustice," including the minimum wage/social welfare debate, has played a role in state elections giving the Far Left an unexpected windfall. Left untended, the current taxation scandal could further erode support for the Coalition parties in 2009. "Change" may re-enter the German political lexicon.

¶13. This message has been coordinated with CONGENS Dusseldorf, Leipzig and Munich.

TIMKEN, JR